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# In Our Opinion...

The Newsletter of the AICPA Auditing Standards Team

Vol. 13 No. 1

January 1997

## New Fraud Standard About to Be Issued

by Jane M. Mancino

In February 1997, the AICPA's Auditing Standards Board (ASB) will issue Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit*. The ASB is issuing this new standard to enhance auditor performance and to provide auditors with additional operational guidance on the consideration of material fraud in a financial statement audit. Following are some questions and answers about the new standard.

### Does the new SAS change the auditor's responsibility for the detection of fraud?

The auditor's detection responsibility will not change but the auditor's performance requirements will be strengthened. The new standard clearly articulates the independent auditor's responsibility, that is, to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. SAS No. 82 will aid the auditor in

fulfilling that responsibility and is thus expected to drive auditor performance.

### What does the new SAS require?

The new standard provides helpful guidance to auditors in fulfilling their responsibility for detecting material misstatements resulting from fraud. Specifically, the standard—

- Describes two types of fraud — fraudulent financial reporting and misappropriation of assets — that are relevant to the auditor's consideration of fraud in a financial statement audit.
- Requires the auditor to specifically assess the risk of material misstatement due to fraud in every audit and provides categories of fraud risk factors that the auditor should consider in making that assessment. It also provides examples of fraud risk factors that, when present, might indicate the presence of fraud.
- Provides guidance on how the auditor responds to the results of the assessment.
- Provides guidance on the evaluation of test results as they relate

to the risk of material misstatements due to fraud.

- Requires the auditor to document risk factors identified as present and any related response.

### What are some of the risk factors related to fraud?

The SAS provides examples of risk factors relating to fraudulent financial reporting including a known history of securities law violations and domination of management by a single person or a small group without compensating controls. Examples of risk factors relating to misappropriation of assets include lack of job applicant screening procedures for employees with access to assets susceptible to misappropriation, and poor physical safeguards over cash, investments, inventory or fixed assets.

### How will the new standard affect entities being audited?

The new standard will require auditors to ask management about the risk of fraud and whether they have knowledge of fraud that has

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American Institute of Certified Public Accountants

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been perpetrated on or within the entity. If the entity under audit has a program that includes steps to prevent, deter, or detect fraud, the auditor will inquire of persons overseeing that program as to whether the program has identified any fraud risk factors. The auditor may communicate to management risk factors that the auditor has identified. This is expected to encourage management to improve fraud prevention and detection techniques.

### How will the new standard affect audit fees?

Many clients will want to know how SAS No. 82 will affect their audit fee. The effect on audit fees will vary. Some organizations have very strong internal control, management that is concerned about fraud and its effects on the entity, and controls that are designed to prevent and detect fraud. For these organizations, the impact on audit fees should not be significant. For organizations with fraud risk factors that are not effectively addressed by management, the costs will be greater. The profession believes that the public interest benefit will outweigh the additional cost. Also, organizations concerned about such costs can take measures to reduce them by implementing controls designed to prevent and detect fraud.

### When does the new SAS become effective?

SAS No. 82, which supersedes SAS No. 53, *The Auditor's Responsibility for the Detection of Errors and Irregularities*, is effective for audits of financial statements for

periods ending on or after December 15, 1997.

### Will there be guidance for implementing the new SAS?

The AICPA is undertaking a major initiative to assist auditors in understanding and implementing SAS No. 82. Implementation efforts include:

- A CPE self-study course, *Consideration of Fraud in a Financial Statement Audit: The Auditor's Responsibilities Under SAS No. 82*, that will be available March 1, 1997. Recommended CPE credit: 8 hours. A seminar version of the course will be available through state societies after April 15, 1997. (Product no. 732045, cost \$119. To order, call 1-800-TO-AICPA and ask for operator PC)
- A publication, titled *Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82*, that will walk the practitioner through the issues likely to be encountered in applying the new SAS to audits and will provide valuable tools, such as sample documentation. It will also provide specific guidance on applying the concepts of the SAS to several industries. This publication will be available a few weeks after issuance of SAS No. 82. (Product No. 008883, cost \$74, pre-publication discount cost \$59. To order, call 1-800-TO-AICPA and ask for operator PC)
- A series of half-day presentations on implementing SAS No. 82 by members of the Auditing Standards Board and AICPA senior staff involved in the development of the SAS.

Recommended CPE credit: 4 hours

April 28, 1997	Colorado Springs & Boston
April 29, 1997	Los Angeles & St. Louis
April 30, 1997	Dallas & Cleveland
May 8, 1997	Chicago & New Orleans
May 9, 1997	New York & Washington, DC

For information and to register, call 1-800-TO-AICPA and ask for operator WR.

- Communication about the SAS to the public and the business community. Articles about the new SAS have already appeared in the *New York Times*, *Wall Street Journal*, *Atlanta Constitution*, *Business Week*, and other publications.
- Helpful guidance about the new SAS, including a press release, speech outline, and comparison of SAS No. 82 with SAS No. 53, will be available on both the AICPA's WEB Page and the Accountants' Forum on CompuServe.
- Lecture notes and a student outline of SAS No. 82 will be distributed to auditing professors in colleges and universities across the nation.

### Upcoming ASB Meetings

ASB meetings are open to the public. For ASB agenda information, call 1-800-TO-AICPA.

February 5-6, 1997  
Palm Springs, CA

April 22-24, 1997  
New York, NY

# Two New SASs Issued by the ASB in December 1996

In December 1996, the work of two task forces of the Auditing Standards Board (ASB) culminated in the issuance of two new Statements on Auditing Standards (SASs), SAS Nos. 80 and 81.

The Electronic Evidence Task Force had been charged with the responsibility of considering whether existing guidance regarding evidential matter in the audit and attestation literature required revision, given that a significant amount of evidential matter is currently in electronic format. In response to that charge, the task force drafted SAS No. 80, Amendment to SAS No. 31, Evidential Matter (Product No. 060673), which provides guidance to auditors in auditing the financial statements of entities for which significant information is transmitted, processed, maintained or accessed electronically. As indicated by its title, the new SAS amends SAS No. 31, and is effective for engagements beginning on or after January 1, 1997.

The SAS includes examples of evidential matter in electronic form and requires that an auditor consider the period during which electronic evidential matter will be in existence or available in determining the nature, timing, and extent of the auditor's substantive tests. The SAS indicates that in certain engagements for which evidential matter is in electronic form, it may not be practical or possible to reduce

detection risk to an acceptable level by only performing substantive tests. In those circumstances, the auditor would be required to perform tests of controls to support an assessed level of control risk below the maximum for the affected assertions.

The task force also has drafted an Auditing Procedure Study (APS), titled *The Information Technology Age: Evidential Matter in the Electronic Environment* (Product No. 021068), which will be issued in January 1997. The APS provides guidance to auditors in applying SAS No. 80 by describing electronic evidence, illustrating the implications of electronic evidence on the audit, and presenting possible audit approaches. The APS includes two case studies that present approaches an auditor might use to audit the financial statements of entities for which the electronic environment and the use of information technology significantly affect information and transactions.

The ASB also issued SAS No. 81, *Auditing Investments* (Product No. 060672), in December which revises the guidance on auditing investments to make that guidance consistent with recently issued accounting standards, particularly Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SAS No. 81 supersedes AU Section 332, "Long-Term Investments," which

needed updating because it was based on FASB Statement No. 12, *Accounting for Certain Marketable Securities*, an accounting standard that was superseded by FASB Statement No. 115. Under FASB Statement No. 115, management's intent related to an investment (whether it plans to sell an investment or hold on to it) and an entity's ability to hold that investment affect the accounting for the investment. Accordingly, the new SAS provides guidance to auditors on evaluating management's intent and an entity's ability to hold an investment.

SAS No. 81 is applicable to audits of financial statements that contain assertions about investments in debt securities and equity securities (as those terms are defined in FASB Statement No. 115), and investments accounted for under Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. The guidance in SAS No. 81 related to investments accounted for using the equity method of accounting is generally unchanged from the guidance contained in the previous standard.

The SAS also contains guidance on auditing assertions about the valuation of investments, and evaluating other-than-temporary impairment conditions related to an investment. SAS No. 81 is effective for audits of financial statements for periods ending on or after December 15, 1997, with early application permitted.



## Three New Members Appointed to the ASB

In January 1997, Deborah Lambert, Chas McElroy, and Glenn Vice completed their terms as ASB members after having made substantial contributions to the work of the ASB and the auditing and attestation literature. The three new members of the ASB are J. Michael Inzina, Charles E. (Chuck) Landes, and Alan Rosenthal.

J. Michael Inzina recently joined the firm of Stagni & Company LLC in Metairie, Louisiana after having served as managing shareholder at Hill, Inzina & Company, CPAs where he concentrated in governmental and non-profit accounting, auditing, and consulting. He is a former chapter president and member of the Board of Directors of the Society of Louisiana Certified Public Accountants and has served on numerous Louisiana Society committees. He is a former member of the AICPA Professional Ethics Executive Committee, Governmental Technical Standards Subcommittee, and the Independence and Behavioral Standards Subcommittee. He is an accomplished continuing education instructor and has been recognized as an outstanding instructor by the AICPA and state CPA societies.

Charles E. Landes is Director of Accounting and Auditing for the firm of Spaeth & Batterberry, Ltd. in

Cincinnati, Ohio. He has been active in the peer review process having served as chair of the AICPA's PCPS Peer Review Committee and member of the SEC Peer Review Committee and the Peer Review Board. Prior to joining the ASB, Chuck served on the ASB's Joint Task Force on Quality Control Standards. He is a member of the Board of Directors of the Ohio Society of CPAs and serves his alma mater, Miami University, as a member of its Accounting Department's Advisory Board.

Alan Rosenthal recently joined the firm of Reitberger, Pollekoff & Kozak in Vienna, Virginia after having served as an audit principal in the professional corporation of Reznick, Fedder & Silverman in Bethesda, Maryland for a number of years. He is a member of the Maryland Association of CPA's Peer Review Committee, and has served on Maryland's ethics and auditing standards committees. Alan has taught numerous continuing professional education (CPE) courses, and served as technical editor for several AICPA CPE courses including "Audits of HUD-Assisted Projects" and "Audits of Multifamily and Single Family Mortgagees and Loan Correspondents." Alan received a BS in Accounting from the University of Maryland and an MS in Taxation from American University.

## Highlights of Technical Activities

The ASB performs its work through task forces consisting of members of the ASB and others with technical expertise in the subject matter of the project. The findings of the task forces are periodically presented at ASB meetings for the ASB's discussion. Listed below are the current task forces of the ASB and a brief summary of each task force's objective and current activities.

### SAS Task Forces

**Analytical Procedures** (Staff Liaison: Kim M. Gibson). The task force is completing an Auditing Procedure Study (APS) that will provide guidance on the use of analytical procedures. The APS will include a

discussion of analytical procedures, relevant questions and answers, and case studies, including a case study using regression analysis.

**Auditor Communications** (A. Louise Williamson). The task force is examining the CPA's communication responsibilities (other than reporting) in auditing and attestation engagements to determine if the standards for those engagements require revision with respect to those responsibilities. In 1996, the task force presented to the ASB a draft of a proposed Statement on Auditing Standards (SAS) and Statement on Standards for Attestation Engagements (SSAE) titled, *Establishing an Understanding With the Client*, that would amend existing

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## Highlights of Technical Activities *(continued from page 4)*

standards (AU section 310 and AT section 100) to provide guidance on establishing an understanding with a client about the nature, scope, and limitation of the services to be performed. The ASB voted to ballot the proposed SAS/SSAE for issuance as an exposure draft and expects to issue the exposure draft in the first quarter of 1997 with a comment period ending on June 15, 1997. The exposure draft also will be available on the Accountant's Forum when issued. In addition, the ASB concluded that the issue of restricted use and limited distribution of reports should be considered by the ASB, and a new task force has been formed to address this issue.

**Auditing Investments Task Force** (Judith M. Sherinsky). See "Two New SASs Issued by the ASB in December 1996" on page 3 for an update on this task force.

**Communications Between Predecessor and Successor Auditors** (Kim M. Gibson). The task force has drafted a proposed SAS that would supersede SAS No. 7, *Communications Between Predecessor and Successor Auditors*. The proposed SAS (1) revises the definitions of predecessor auditor and successor auditor to reflect the current proposal environment, (2) expands the successor auditor's communication requirements prior to accepting an engagement to include communication with the audit committee or others with equivalent authority, (3) clarifies the successor auditor's responsibility for obtaining evidential matter concerning the opening balances and the consistency of the accounting principles used, and (4) includes illustrative optional client consent and acknowledgment letters and an illustrative successor auditor acknowledgment letter. At its December 1996 meeting, the ASB voted to ballot the proposed SAS for issuance as an exposure draft and expects to issue the exposure draft in the first quarter of 1997 with a comment period ending in June 1997. The exposure draft will also be available on the Accountant's Forum when issued.

**Electronic Dissemination of Audited Financial Information Task Force** (Kim M. Gibson). This new task force will be considering issues concerning the electronic dissemination of audited financial statements and related auditors' reports as well as other information that

an accountant has reported on. Matters to be considered by the task force may include, but are not limited to (1) whether an accountant has an obligation to determine if his or her report and the information to which it relates will be disseminated electronically, and (2) the accountant's responsibility for the electronic version of the information attested to and for other information that might be associated with the information attested to.

**Electronic Evidence Task Force** (A. Louise Williamson). See "Two New SASs Issued by the ASB in December 1996" on page 3 for an update on this task force.

**Environmental Issues Task Force** (Judith M. Sherinsky). The task force drafted a chapter titled "Auditing Environmental Remediation Liabilities" that is included as an appendix in the Accounting Standards Executive Committee's Statement of Position (SOP), *Environmental Remediation Liabilities*. The guidance presents the recommendations of the task force regarding the application of generally accepted auditing standards to the audit of an entity's financial statements as it relates to environmental remediation liabilities. The SOP was issued in September 1996.

**Fraud** (Jane M. Mancino). See "New Fraud Standard About to be Issued" on page 1 for an update on this task force.

**Ownership, Existence, and Valuation Task Force** (Judith M. Sherinsky). The task force is considering the auditor's responsibility for auditing financial statement assertions about the ownership, existence, and valuation of financial instruments, commodity contracts, and similar instruments. The task force has drafted a proposed SAS titled, *Auditing Procedures to Be Considered When Evaluating Assertions as to the Fair Value of Financial Instruments*. At its December 1996 meeting, the ASB discussed the draft and will review a revised draft at the February 1997 meeting. The task force also is investigating the auditor's responsibility for auditing financial statement assertions about the existence and ownership of financial instruments in situations in which an entity uses a service organization to maintain custody of the

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## Highlights of Technical Activities *(continued from page 5)*

financial instruments. The ASB discussed this issue at its December meeting and the task force will begin to develop guidance based on the ASB's input.

**SAS No. 19 Task Force** (Kim M. Gibson). The task force is revising SAS No. 19, *Client Representations*, to reflect current practice and current generally accepted accounting principles. The task force also has identified several issues related to SAS No. 19, including obtaining a representation from management that the financial statements are fairly presented, encouraging the auditor to obtain a tailored representation letter, clarifying the appropriate dating of representation letters if the client signs the letter after the date of the audit report, and incorporating the existing interpretations into the revised SAS. The task force will present a revised draft of SAS No. 19 at the February 1997 ASB meeting.

**SAS No. 70 Task Force** (Judith M. Sherinsky). The task force is revising the APS, *Implementing SAS No. 70, Reports on the Processing of Transactions by Service Organizations*, (Product No. 021056) to reflect the changes introduced by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55*. The task force is also considering possible changes to the APS that might be required as a result of the findings of the Ownership, Existence, and Valuation (OEV) task force. Representatives of the task force met with the OEV task force in December 1996 and participated in the ASB's discussion of issues that are of mutual interest to both task forces.

**Restricted Use Task Force** (A. Louise Williamson). This new task force, which expects to begin its work in the first quarter of 1997, will examine the auditing and attestation standards that prescribe restrictions on the use or distribution of accountants' reports, and address related practice issues. The task force will draw on the work performed by the Technical Audit Advisors Task Force and will consider whether standards should be developed that describe characteristics of the subject matter, the nature of the engagement, and other factors that would necessitate a restriction on the use of the accountants' report. In addition, the task force will consider certain conforming changes to the existing standards and other recommendations of the Technical

Audit Advisors Task Force.

### SSAE Task Forces

**Attestation Recodification Task Force** (A. Louise Williamson). The task force was formed to determine whether the SSAEs require amendment or interpretation. In response to threshold issues presented by the task force at the December 1996 ASB meeting, the ASB directed the task force to (1) consider whether a single framework for the SASs, the SSAEs, and the Statements on Standards for Accounting and Review Services (SSARSs) would be appropriate (2) develop guidance that would amend the SSAEs to permit direct reporting and eliminate the requirement for a written assertion in certain cases, and (3) submit the list of identified technical inconsistencies in the SSAEs to the Technical Audit Advisors Task Force for further analysis.

**Management's Discussion and Analysis (MD&A)** (Beth Schneider/Deloitte & Touche LLP). This task force is developing an SSAE that would provide guidance on reporting on MD&A. In its deliberations, the task force is considering the 1987 exposure draft, *Examination of Management's Discussion and Analysis*, and related comment letters, and the Comprehensive Model for Financial Reporting proposed by the AICPA Special Committee on Financial Reporting. At its December 1996 meeting, the ASB voted to ballot the proposed SSAE for issuance as an exposure draft.

**SEC Auditing Practice** (Jane M. Mancino). The task force monitors regulatory developments affecting accountants' involvement with financial information in filings with the Securities and Exchange Commission (SEC) and considers the need for, and develops as necessary, guidance in the form of SASs, SSAEs, auditing interpretations, or guides. Liaison with the SEC is maintained through the Audit Issues Task Force.

### Other Task Forces and Committees

**Accounting and Review Services Committee** (Judith M. Sherinsky). The committee met in January 1997 to consider whether SSARS No. 1, *Compilation and Review of Financial Statements*, should be amended or interpreted to preclude a CPA from compiling financial state-

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## Highlights of Technical Activities (continued from page 6)

ments for a client if the CPA performs functions for that client equivalent to those performed by management. The Committee also discussed the issue of plain-paper financial statements.

**Audit Issues Task Force** (Julie Anne Dilley). The task force meets on a monthly basis to assist the Chair of the ASB and the Audit and Attest Standards staff with the technical review of audit issues.

**Computer Auditing Subcommittee** (Jane M. Mancino). The subcommittee is working on two auditing procedure studies (APSs). One APS, *Auditing in a Client/Server Environment*, describes client/server computing and its possible effects on a financial statement audit. The second APS, drafted with the Canadian Institute of Chartered Accountants, describes electronic document management and possible audit implications. Both APSs will be issued in the second quarter of 1997.

**Forecasts and Projections Task Force** (Robert Durak). An ad hoc group of this task force is currently revising the AICPA Audit Guide, *Guide for Prospective Financial Information*, to reflect SSAE No. 4, *Agreed-Upon Procedures Engagements*, and the Private Securities Reform Act of 1995.

**International Auditing Practices** (Thomas Ray). The current agenda of the International Auditing Practices Committee (IAPC) includes developing assurance standards and revising the International Standards on Auditing (ISAs) dealing with audit sampling, going-concern, environmental issues, confirmations, and prospective financial information. An analysis comparing the ISAs with the SASs to identify instances when international auditing standards exceed U.S. auditing standards is included in the *Codification of Statements on Auditing Standards* as of January 1, 1996.

**Joint Task Force on Quality Control Standards** (Kim M. Gibson). In May 1996, the ASB issued two new Statements on Quality Control Standards (SQCS). SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (Product No. 067018), is a general standard that requires a CPA firm to have a sys-

tem of quality control for its accounting and auditing practice. It describes the five broad elements of quality control and other matters essential to the effective implementation of the system. SQCS No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice* (Product No. 067019), provides guidance on how a CPA firm can implement the monitoring element of a quality control system in its accounting and auditing practice. The task force has also written a booklet titled *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (Product No. 067020) which provides CPA firms with guidance on implementing and maintaining a system of quality control.

**Technical Audit Advisors Task Force** (Thomas Ray). The task force receives assignments, on an on-going basis, from the Audit and Attest Standards staff and the Audit Issues Task Force. The task force is currently considering certain inconsistencies in the attestation standards and other related matters, and will make recommendations to the Attestation Recodification Task Force on their resolution.

### Auditing Procedure Studies

Auditing Procedure Studies (APSs) provide nonauthoritative guidance on the implementation of auditing and attestation standards. In addition to the APSs mentioned in the task force summaries above, the Audit and Attest Standards staff is currently revising the following APSs.

**Audits of Small Businesses** (Thomas Ray). This APS discusses the characteristics of a small business that often affect the conduct of an audit, and provides practitioners with guidance on the implementation of related auditing standards in small business audit engagements. It is being revised to reflect the issuance of certain auditing standards subsequent to its publication. The revised edition will be available in Summer 1997.

**Audit Sampling**. This APS will supercede the existing audit guide and will reflect recently issued auditing standards. It is expected to be issued in the second quarter of 1997.



## **Highlights of Technical Activities** *(continued from page 7)*

*Confirmation of Accounts Receivable* (2nd edition revised). This APS has been revised to reflect recent auditing standards and is currently available (Product No. 021064).

For additional information about Auditing Standards Division and ASB projects, call (212) 596-6036.

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